

## ANALYSIS OF AMENDED BILL

Author: Assy. Rev. & Tax Comm. Analyst: Jeani Brent Bill Number: AB 2809  
Related Bills: See Legislative History Telephone: 845-3410 Amended Date: 04/27/98  
Attorney: Doug Bramhall Sponsor: Franchise Tax Board

**SUBJECT:** Economic Development Areas/Hiring Credit for Employers of Seasonal Employees/NOL Separate Code Sections/LARZ NOL Sunset Date Technical Change

- ☒ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced March 24, 1998.
- ☐ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- ☐ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended \_\_\_\_\_.
- ☐ FURTHER AMENDMENTS NECESSARY.
- ☐ DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.
- ☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED March 24, 1998, STILL APPLIES.
- ☒ OTHER - See comments below.

### SUMMARY OF BILL

This bill, sponsored by the Franchise Tax Board, would correct a chaptering error by reinstating the December 1, 1998, sunset date of the Los Angeles Revitalization Zone (LARZ) net operating loss (NOL) as enacted by AB 18 (Stats. 1993, Ch. 18). Additionally, to prevent potential future chaptering problems with the various economic development area NOL provisions, this bill would place each economic development area NOL provision into a separate code section, rather than in a subdivision of the same code section.

This bill also would make the following changes to the economic development area hiring credits:

- Credit Percentage:** clarify that the reemployment of seasonal employees shall not constitute commencement of employment. Instead, these employees would be considered continuously employed for purposes of the credit computation.
- Recapture:** provide that the recapture rules apply to credits taken for wages paid to any seasonal employee who is not rehired in the applicable subsequent seasons. Also, define "seasonal employment."

### DEPARTMENTS THAT MAY BE AFFECTED:

___ STATE MANDATE		___ GOVERNOR'S APPOINTMENT	
Board Position: <input checked="" type="checkbox"/> S      ___ O ___ SA      ___ OUA ___ N      ___ NP ___ NA      ___ NAR ___ PENDING	Agency Secretary Position: ___ S      ___ O ___ SA      ___ OUA ___ N      ___ NP ___ NA      ___ NAR DEFER TO _____	<b>GOVERNOR'S OFFICE USE</b>  Position Approved      ___ Position Disapproved      ___ Position Noted      ___  By:      Date:	
Department/Legislative Director      Date <b>Gerald H. Goldberg</b> <b>5/4/98</b>	Agency Secretary      Date		

#### SUMMARY OF AMENDMENT

The proposed amendments would include the provisions discussed in this analysis relating to hiring credit for employers of seasonal employees. In addition, the proposed amendments accepted technical amendments provided by the department to correct three typographical errors in the bill as introduced March 24, 1998. In addition to the analysis provided below, the department's analysis of the bill as introduced March 24, 1998, still applies.

#### EFFECTIVE DATE

1. **Credit Percentage:** Clarifying that the reemployment of seasonal employees shall not constitute commencement of employment for purposes of the hiring credit would be declarative of existing law and, thus, would apply to all taxable or income years from the effective date of the hiring credits.
2. **Recapture:** Providing recapture rules for credits taken for wages paid to any seasonal employee that is not rehired in the applicable subsequent seasons would apply to taxable or income years beginning on or after January 1, 1998.

#### LEGISLATIVE HISTORY

AB 3, AB 69, AB 82, AB 638, AB 809, AB 1217 (Stats. 1997, Ch. 602), SB 200 (Stats. 1997, Ch. 609), SB 635, SB 965 (Stats. 1997, Ch. 603); AB 2456 (1996), AB 296 (Stats. 1996, Ch. 953), SB 715 (Stats. 1996, Ch. 952), SB 2023 (Stats. 1996, Ch. 955); SB 712 (Stats. 1995, Ch. 494); AB 2206 (Stats. 1994, Ch. 853), SB 1438 (Stats. 1994, Ch. 754), SB 1770 (Stats. 1994, Ch. 755).

#### PROGRAM HISTORY/BACKGROUND

California has five types of economic development areas (EDAs) that have similar tax incentives:

Enterprise Zone (EZ),  
Los Angeles Revitalization Zone (LARZ),  
Local Agency Military Base Recovery Area (LAMBRA),  
Targeted Tax Area (TTA), and  
Manufacturing Enhancement Area (MEA).

The following table shows the incentives available to each of the economic development areas.

Types of Incentives	EZ	LARZ	LAMBRA	TTA	MEA
Sales or Use Tax Credit	X	X	X	X	
Hiring Credit	X	X	X	X	X
Construction Hiring Credit		X			
Employee Wage Credit	X				
Business Expense Deduction	X	X	X	X	
Net Interest Deduction	X	X			
Net Operating Loss	X	X	X	X	

### SPECIFIC FINDINGS

**Existing federal law** provides special tax incentives for empowerment zones and enterprise communities to provide economic revitalization of distressed urban and rural areas. The Secretary of Housing and Urban Development and the Secretary of Agriculture designated nine empowerment zones and 95 enterprise communities from areas nominated by state and local governments. In addition, two Supplemental Enterprise Zones (one in Los Angeles) and four Enhanced Enterprise Communities (one in Oakland) were designated. Twenty-two additional empowerment zones recently were authorized by Congress in the Taxpayer Relief Act of 1997.

Qualified zone businesses operating in federal empowerment zones and federal enterprise communities are eligible to finance property with a new category of exempt facility private activity bonds. This exempt bond is the only incentive available to enterprise communities. Two additional incentives are available in empowerment zones: qualified empowerment zone businesses are allowed an additional \$20,000 depreciation expense deduction and employers are entitled to a 20% credit for the first \$15,000 of wages paid to qualified empowerment zone employees. To be "qualified," an employee must, among other criteria, (1) work for the employer for 90 days or more, (2) not be related to the taxpayer, and (3) not own more than 5% of the outstanding stock of the taxpayer. The Supplemental Empowerment Zones and Enhanced Enterprise Communities receive economic development grants and social services grants, but no special tax benefits. The employment credit is not available for 20 of the 22 additional empowerment zones, but the additional depreciation expense is available.

**Existing state law** provides special tax incentives for taxpayers conducting business activities within economic development areas. These incentives include the business expense deduction, special net operating loss treatment, net interest deduction, hiring credit, construction hiring credit, and sales or use tax credit.

In the case of the hiring credit, a taxpayer located in an economic development area may reduce tax by a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated as an economic development area and meet certain other criteria. The credit is based on the lesser of the actual hourly wage paid or 150% of the current minimum hourly wage. The amount of the credit must be reduced by any other federal or state jobs tax credits, and the taxpayer's deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring credit. Certain criteria regarding qualified employees and limitations differ among the five types of economic development areas.

### **Credit Percentage**

The credit may be claimed for wages paid during the first five years (60 months) of employment. This 60-month period begins when the qualified employee first commences employment with the taxpayer. The taxpayer may claim a credit for 50% of the wages paid during the first year of employment to a qualified employee. Each subsequent year the allowable percentage decreases 10% until the credit no longer is available (e.g., 40% of the wages paid during the second year of employment, 30% for the third year, 20% for the fourth year, and 10% for the fifth year).

## **Recapture**

If the taxpayer terminates an employee within a specified period, the taxpayer must recapture the amount of the credit attributable to that employee's wages. The taxpayer must add to the tax in the year of termination the amount of credit allowed for that taxable or income year and all prior taxable or income years attributable to qualified wages paid or incurred with respect to the terminated employee. The increase in tax attributable to the recapture of the hiring credit cannot be offset by other enterprise zone, LARZ, or LAMBRA credits.

The recapture rules do not apply if the termination was:

1. Voluntary on the part of the employee;
2. Caused by the employee becoming disabled;
3. The result of employee misconduct;
4. Due to a substantial reduction in business;
5. Carried out so that other qualified individuals could be hired, creating an increase in the number of qualified employees and their hours of employment.

The hiring credit statutes for all existing EDAs do not address how the credit percentage and recapture provisions are to be applied to taxpayers for wages paid to seasonal employees.

**This bill** would make the following changes to the economic development area hiring credits:

1. **Credit Percentage:** clarify that the reemployment of seasonal employees shall not constitute commencement of employment. Instead, these employees would be considered continuously employed for purposes of the credit computation.
2. **Recapture:** provide that the recapture rules apply to credits taken for wages paid to any seasonal employee who is not rehired in the applicable subsequent seasons. Also, define "seasonal employment."

### Policy Considerations

**Credit Percentage:** For employers that employ the same seasonal employee each season, the statutes are reasonably clear regarding the allowable credit percentage for the subsequent years. An employer that hires the same seasonal employee in the second season would receive a credit for 40% of wages paid during the second year of employment because the 60-month period of employment began when the seasonal employee was first employed by the taxpayer. This interpretation of the statute holds that the credit percentage is the same for all taxpayers, whether employing an individual as a full-time or a seasonal employee: decreased 10% each year. However, some taxpayers may interpret the statute to provide that at the end of each season, seasonal employees are terminated because of a substantial reduction in business. Following this interpretation, the taxpayer could claim a 50% credit each year for the same employee. To reduce the possibility for disputes between taxpayers and the department, this bill would clarify that seasonal employees are continuously employed.

**Recapture:** For taxpayers that do not rehire the same seasonal employee each season, the statute does not require recapture in any circumstance. The

effect of statutorily providing that the credit percentage declines each year for employing the same employee and not requiring recapture provides an incentive to taxpayers to hire a new seasonal employee each year and a disincentive to rehire the same seasonal employee each year. This bill would resolve this issue by providing rules for seasonal employees.

#### Implementation Considerations

Implementing this bill would occur during the department's normal annual system update.

#### FISCAL IMPACT

##### Departmental Costs

No departmental costs are associated with this bill.

##### Tax Revenue Estimate

1. **Credit Percentage:** This provision would be declarative of existing law and thus would not impact the state's income tax revenue.
2. **Recapture:** The number of seasonal employees who are not rehired in the applicable subsequent seasons and who have previously qualified employers for the hiring credit is not known. The revenue gain from providing recapture rules would be minor.

#### POSITION

Support.

The Franchise Tax Board voted at its November 17, 1997, meeting to sponsor the language in this bill.